

Customs and Border Protection

Proposed Rulemaking

19 CFR Part 181

RIN 1515-AD23

TARIFF TREATMENT RELATED TO DISASSEMBLY OPERATIONS UNDER THE NORTH AMERICAN FREE TRADE AGREEMENT

AGENCY: U.S. Customs Service, Department of the Treasury.

ACTION: Proposed rule.

SUMMARY: This document proposes to amend the Customs Regulations concerning the North American Free Trade Agreement (the NAFTA). Specifically, the proposed rule would allow components which are recovered from the disassembly of used goods in a NAFTA country to be entitled to NAFTA originating status when imported into the United States, provided that: the recovered components satisfy the applicable NAFTA rule of origin requirements; and if the applicable rule of origin does not include a regional value content requirement, the components are subject to further processing in the NAFTA country beyond certain minor operations.

The proposed rule is intended to promote economic activity and the protection of the environment in North America, both of which are goals of the NAFTA. To this end, the recovery and recycling of used goods is a critical element in both the economic activity and the environmental goals of the nation, and disassembly for the recovery of used goods is a key process in many such recycling operations.

DATES: Comments must be received on or before May 12, 2003.

ADDRESSES: Written comments are to be addressed to the U.S. Customs Service, Office of Regulations and Rulings, Attention: Regulations Branch, 1300 Pennsylvania Avenue, NW., Washington, D.C. 20229. Submitted comments may be inspected at U.S. Customs Service, 799 9th Street, NW., Washington, D.C. during regular business hours. Arrangements to inspect submitted comments should be made in advance by calling Mr. Joseph Clark at (202) 572-8768.

FOR FURTHER INFORMATION CONTACT: Edward M. Leigh, Office of Regulations and Rulings, (202) 572-8827.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 17, 1992, the United States, Canada and Mexico (the parties) entered into an agreement, the North American Free Trade Agreement (the NAFTA). The provisions of the NAFTA were adopted by the United States with the enactment of the North American Free Trade Agreement Implementation Act, Pub. L. 103-182, 107 Stat. 2057 (December 8, 1993).

The question has arisen, in the context of recycling or re-manufacturing operations, whether disassembly occurring in a NAFTA country may be considered NAFTA origin conferring "production" where the components recovered by disassembly satisfy the Annex 401 rules of origin for the NAFTA and there is some form of substantial processing performed on the recovered components.

The NAFTA does not explicitly address whether parts or components, whose origin is non-NAFTA or unknown, that are recovered by disassembly in a NAFTA country from a non-originating good, may qualify as NAFTA originating goods if, as a result of the disassembly, they satisfy the rules of origin set out in Article 401 and Annex 401 of the NAFTA and are themselves subjected to some form of substantial further processing.

The recovery and recycling of used goods is an increasingly important element in the economic activity as well as the environmental goals of the nation, and disassembly, for the recovery of parts or for the re-manufacturing of a good, is a key process in many recycling operations.

The goals of the North American Free Trade Agreement (NAFTA) include elimination of barriers to trade, facilitation of cross-border movement of goods, promotion of economic activity in North America, and protection of the environment. The Department of the Treasury and Customs Service have examined NAFTA's rules of origin as applied to both recovered and recycled goods. Allowing disassembly to confer origin under certain circumstances promotes recycling and re-manufacturing in North America and would advance these economic and environmental objectives.

PROPOSED RULE

To this end, accordingly, this document proposes to amend the Customs Regulations to allow components which are recovered from the disassembly of used goods in a NAFTA country to be entitled to NAFTA originating status upon importation to the United States, provided that: (1) the recovered components satisfy the applicable NAFTA rule of origin requirements in Annex 401; and (2) if the rule of origin in Annex 401 applicable to the components does not include a regional value content requirement, the components are subject to further processing in the NAFTA country beyond certain specified minor operations.

TREATMENT OF DISASSEMBLY AS A PRODUCTION CONSISTENT WITH THE INTENT OF NAFTA

Under the proposal, treatment of disassembly as potentially conferring NAFTA originating status must, of course, be consistent with the terms and objectives of the NAFTA Implementation Act of 1993. Within that framework, the most important question which must be answered is does “disassembly” constitute origin conferring “production” within the meaning of that term as defined in Article 415 of the NAFTA, as implemented in 19 U.S.C. 3332(a)(1)(B)(i) and 3332(p)(22) and in Section 2(1) of the NAFTA Rules of Origin Regulations (Uniform Regulations) (19 CFR part 181, Appendix, Section 2(1))?

A CHANGE IN TARIFF CLASSIFICATION RESULTING FROM A PRODUCTION

Under NAFTA Article 401(b) and 19 U.S.C. 3332(a)(1)(B)(i), a good shall originate in the territory of a party where each of the non-originating materials used in the *production* of the good undergoes an applicable change in tariff classification set out in Annex 401 as a result of *production* occurring entirely in the territory of one or more of the parties. It is therefore understood that unless it results from an activity that qualifies as “production”, the mere fact that there is a prescribed change in tariff classification will not be considered as meeting a rule of origin.

The term “production” is defined in Article 415 of the NAFTA and in 19 U.S.C. 3332(p)(22) and is implemented in Section 2(1) of the Uniform Regulations (19 CFR part 181, Appendix, Section 2(1)). As noted, the term, in relevant part, requires a manufacturing, processing or assembling of a good. Of course, the processes listed here are illustrative, not exhaustive, and the absence of the term “disassembly” is not dispositive of whether or not a disassembly operation is a production process for NAFTA purposes.

A disassembly operation will result in one or more articles being taken or separated from a manufactured good. Assuming no further production, these various articles are typically classifiable under tariff provisions (often those for “parts” of goods) other than the classification of the original good from which the articles were disassembled. Consequently, if disassembly is treated as production and any other requirements are satisfied, the recovered component may satisfy the NAFTA rules of origin.

DISASSEMBLY AS A PRODUCTION PROCESS

Upon review, we find no evidence (beyond the failure to explicitly include disassembly in the illustrative list of “production” activities in NAFTA Article 415) showing that the NAFTA intended not to treat “disassembly” as a production process. Use of the term “processing” includes a broad range of economic activity within production. Recycling operations for the recovery by disassembly of reusable components such as automotive parts and photocopier or computer parts constitute identifiable business operations within the NAFTA territories and the free trade purposes of NAFTA (discussed above) would be satisfied by estab-

lishing rules under which substantial “production” consistent with those purposes will be deemed to occur. Recycling operations based on certain repair or alteration operations already have been given appropriate recognition under NAFTA Article 307. Equally, operations based on the recovery of certain waste or scrap materials have been designated in the NAFTA rules of origin as conferring origin where such operations take place (NAFTA Article 415). It is thus consistent with the NAFTA to treat the recovery of useable goods by disassembly as “production” under the NAFTA rules of origin.

CIRCUMVENTION OF NAFTA’S RULES OF ORIGIN; DISASSEMBLY OF NEW PRODUCTS

Moreover, to ensure that disassembly is not used to circumvent the intent of NAFTA, the proposed rule provides that, under certain circumstances, additional operations beyond disassembly are required for the recovered component to acquire NAFTA originating status. Specifically, as previously outlined, the recovered component must meet the requirement of the applicable rule of origin in Annex 401, including any pertinent regional value content requirement; and, if the applicable rule of origin in Annex 401 does not include a regional value content requirement, the recovered component must be subject to additional processing beyond certain minor operations.

Where there is no regional value content requirement applicable to the recovered components, the additional processing operations necessary to confer NAFTA originating status must involve more than certain minor operations which are enumerated as follows: (1) Cleaning or sterilizing, including removal of rust, grease, paint, or other coatings; (2) Application of preservative or decorative coatings, including lubricants, protective encapsulation, preservative or decorative paint, or metallic coatings; (3) Trimming, filing or cutting off small amounts of excess materials (precision machining, however, is not to be considered a minor operation); (4) Unloading, reloading or any other operation necessary to maintain the good in good condition; (5) Packing, re-packing, packaging or repackaging; or (vi) Testing, marking, sorting, or grading.

Customs has also examined whether a producer might use disassembly of new goods to circumvent the intent of the NAFTA. A new non-NAFTA product could be imported into Mexico or Canada, disassembled, and the disassembled parts could then be imported into the United States and either re-assembled or used as parts. Customs believes that a change in tariff classification resulting from the disassembly of new, non-originating goods should not make the resulting goods eligible for originating status. Because the disassembly of new goods may potentially be treated as a circumvention activity within the meaning of Section 17 of the Uniform Regulations (19 CFR part 181, Appendix, Section 17), the proposed rule provides that the disassembly of new goods shall not be considered to be “production” for the purposes of NAFTA Article 415 and the NAFTA rules of origin. Notwithstanding this proposal, Customs is particularly interested in receiving comments

on the contrary view that an applicable value content rule or alternative requirement for substantial processing suffice to permit “production” to be considered to have occurred in this case as well. After reviewing the comments, Customs will issue a final rule that will resolve the question definitively.

To reflect the above-described interpretations of law and substantive considerations, this document proposes to add a new § 181.132 to the Customs Regulations (19 CFR 181.132).

COMMENTS

Before adopting the proposed regulation, consideration will be given to any written comments that are timely submitted to Customs. Customs specifically requests comments on the clarity of the proposed rule and how it may be made easier to understand. Comments submitted will be available for public inspection in accordance with the Freedom of Information Act (5 U.S.C. 552), § 1.5, Treasury Department Regulations (31 CFR 1.5) and § 103.11(b), Customs Regulations (19 CFR 103.11(b)), at the U.S. Customs Service, 799 9th Street, NW., Washington, D.C. during regular business hours. Arrangements to inspect submitted comments should be made in advance by calling Mr. Joseph Clark at (202) 572-8768.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12866

The proposed rule is intended to promote economic activity as well as the protection of the environment in North America, both of which are goals of the NAFTA. Specifically, the recovery and recycling of used goods is a critical element in both the economic activity and the environmental goals of the nation, and disassembly, for the recovery or re-manufacturing of used goods, is a key process in many such operations. Hence, pursuant to the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), it is certified that the proposed rule, if adopted, will not have a significant economic impact on a substantial number of small entities. Accordingly, it is not subject to the regulatory analysis or other requirements of 5 U.S.C. 603 and 604. Nor does the proposed rule result in a “significant regulatory action” under E.O. 12866.

LIST OF SUBJECTS IN 19 CFR PART 181

Administrative practice and procedure, Canada, Customs duties and inspection, Imports, Mexico, Trade agreements (North American Free-Trade Agreement).

PROPOSED AMENDMENTS TO THE REGULATIONS

It is proposed to amend part 181, Customs Regulations (19 CFR part 181), as set forth below.

PART 181—NORTH AMERICAN FREE TRADE AGREEMENT

1. The authority citation for part 181 would continue to read as follows:

Authority: 19 U.S.C. 66, 1202 (General Note 23, Harmonized Tariff Schedule of the United States), 1624, 3314.

2. Subpart L of part 181 is amended by adding a new § 181.132 to read as follows:

§ 181.132 Disassembly

(a) *Treated as a production.* For purposes of implementing the rules of origin provisions of General Note 12, HTSUS, and Chapter Four of the NAFTA, except as provided in paragraph (b) of this section, disassembly is considered to be production, and a component recovered from a good disassembled in the territory of a Party will be considered to be originating as the result of such disassembly provided that:

(1) The recovered component satisfies all applicable requirements of Annex 401 and this part; and

(2) Where the rule in Annex 401 applicable to the recovered component does not include a regional value content requirement, the recovered component is thereafter advanced in value or improved in condition by means of additional processing operations other than those listed below. Merely processing by performing any or all of the following minor operations would not be sufficient to be considered production:

(i) Cleaning or sterilizing, including removal of rust, grease, paint, or other coatings;

(ii) Application of preservative or decorative coatings, including lubricants, protective encapsulation, preservative or decorative paint, or metallic coatings;

(iii) Trimming, filing or cutting off small amounts of excess materials (precision machining, however, is not considered a minor operation);

(iv) Unloading, reloading or any other operation necessary to maintain the good in good condition;

(v) Packing, re-packing, packaging or repackaging; or

(vi) Testing, marking, sorting, or grading.

(b) *Exception; new goods.* Disassembly as provided in paragraph (a) of this section will not be considered a production in the case of components that are recovered from new goods.

(c) *Automotive components/goods.* Notwithstanding the provisions of Schedule V (Automotive Goods) of the Appendix to this part, the rule set forth in this section applies for purposes of determining whether goods of that Schedule are originating.

ROBERT C. BONNER,
Commissioner of Customs.

Approved: February 18, 2003.

TIMOTHY E. SKUD,
Deputy Assistant Secretary of the Treasury.

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